

**Final Statement of Reasons for
Adoption of California Code of Regulations,
Title 18, Section 2558.1, Wine**

Update of Information in the Initial Statement of Reasons

On May 25, 2011, the State Board of Equalization (Board) held a public hearing regarding the proposed adoption of California Code of Regulations, title 18, section (Regulation) 2558.1, *Wine*. The Board received written comments from Richard S. Grey, Vice President – General Counsel for E. & J. Gallo Winery, and Mr. Paul Kronenberg, President of the Family Winemakers of California (FWC), prior to the close of the written comment period, and Mr. Kronenberg also made oral comments during the public hearing. At the conclusion of the public hearing, the Board voted to adopt the proposed regulation pursuant to the authority vested in it by article XX, section 22 of the California Constitution and Revenue and Taxation Code (RTC) section 32451, without making any changes. The proposed regulation clarifies that for purposes of the Alcoholic Beverage Tax Law (RTC § 32001 et seq.) the term “wine,” as defined by Business and Professions Code (BPC) section 23007, does not include any alcoholic beverage containing 0.5 percent or more alcohol by volume obtained from the distillation of fermented agricultural products other than from the particular agricultural product or products of which the wine is made and establishes January 1, 2012, as the prospective date for compliance with the clarified definition of wine. The Board considered Mr. Grey’s and Mr. Kronenberg’s comments prior to the adoption of proposed Regulation 2558.1 and their comments are summarized and responded to below.

The factual basis, specific purposes, and necessity for the adoption of proposed Regulation 2558.1 are the same as provided in the Initial Statement of Reasons.

The Board did not rely on any data or any technical, theoretical, or empirical study, report, or similar document in proposing or adopting proposed Regulation 2558.1 that was not identified in the Initial Statement of Reasons, or which was otherwise not identified or made available for public review prior to the close of the public comment period.

The Board did consider two alternatives to the text of proposed Regulation 2558.1 during its February 23, 2011, meeting. By its motion on February 23, 2011, proposing the adoption of Regulation 2558.1 and its motion on May 25, 2011, adopting the proposed regulation, the Board determined that no alternative to the text of proposed Regulation 2558.1 would be more effective in carrying out the purposes for which the regulation is proposed or would be as effective and less burdensome to affected private persons than the adopted regulation or would lessen the adverse economic impact on small businesses. The two alternatives and the Board’s reasons for rejecting the alternatives are summarized below and in the Initial Statement of Reasons.

Furthermore, the Board has determined that the adoption of proposed Regulation 2558.1 will not have a significant adverse economic impact on business.

No Mandate on Local Agencies or School Districts

The Board has determined that the adoption of proposed Regulation 2558.1 does not impose a mandate on local agencies or school districts.

Response to Public Comments

Prior to the public hearing, Mr. Grey submitted a letter dated May 23, 2011, expressing E. & J. Gallo Winery's support for the adoption of proposed Regulation 2558.1 and stating E. & J. Gallo Winery's opinion that it is "important" for the Board to clarify the definition of "wine" for California tax purposes and that proposed Regulation 2558.1 "is straightforward and should be easy to enforce." Mr. Kronenberg appeared at the public hearing, made oral comments opposing the adoption of the regulation at this time, and submitted a letter dated May 25, 2011, containing similar comments. Mr. Kronenberg's comments expressed the FWC's opinions that:

- The Board lacks "the authority to regulate in this area";
- The Office of Administrative Law's approval of the Board's adoption of the distilled spirits regulations (discussed in the Initial Statement of Reasons) is "not, in FWC's view, determinative" of the Board's authority to adopt proposed Regulation 2558.1;
- The Board should postpone the adoption of proposed Regulation 2558.1 until there is a final decision in *Diageo-Guinness USA, Inc., v. State Board of Equalization* (Sacramento Superior Court Case No. 34-2008-00013031-CU-JR-GDS; and Court of Appeal, Third Appellate District Case No. C061227);¹ and
- The FWC "doesn't believe there is any urgency in adopting the clarification" set forth in proposed Regulation 2558.1.

The Board considered Mr. Grey's and Mr. Kronenberg's comments. The Board determined that it is necessary to adopt proposed Regulation 2558.1 to clarify the classification of wine-based alcoholic beverages containing more than a de minimis amount of alcohol obtained from the distillation of fermented agricultural products other than from the particular agricultural product or products of which the wine is made in order to address the wine growers' and importers' confusion regarding the definition of "wine" for California tax purposes described in the Initial Statement of Reasons.

The Board determined that it is necessary to adopt proposed Regulation 2558.1 now in order "to permit wine growers and importers who had been relying on federal law and/or the Department of Alcoholic Beverage Control's (ABC's) classification of their wine-

¹ Diageo-Guinness USA, Inc., is currently appealing the Superior Court's judgment, which concluded that the Board had the authority to adopt the distilled spirits regulations. The appeal has been briefed, but the Third Appellate District has not set a date for oral argument yet.

based alcoholic beverages for California tax purposes time, without being penalized due to any prior confusion in the industry, to determine whether their wine-based alcoholic beverages are wine or distilled spirits under the Board's regulations, reformulate any of their wine-based alcoholic beverages so that they can continue to qualify as wine for California tax purposes, if necessary and desired, and begin to report and pay the applicable wine or distilled spirits excise tax on their wine-based alcoholic beverages" by the proposed regulation's January 1, 2012, effective date, as explained in the Initial Statement of Reasons.

The Board also determined that it has authority to adopt proposed Regulation 2558.1 based upon the opinion of its Legal Department, as stated during the public hearing, that article XX, section 22 of the California Constitution grants the Board the exclusive jurisdiction to "assess and collect such excise taxes as are or may be imposed by the Legislature on account of the manufacture, importation and sale of alcoholic beverages in this State" and Revenue and Taxation Code section 32451 expressly authorizes the Board to "prescribe, adopt, and enforce rules and regulations relating to the administration and enforcement of" the Alcoholic Beverage Tax Law, including proposed Regulation 2558.1.

Alternatives Considered

The Board did consider two alternatives before it decided to propose the adoption of Regulation 2558.1 during its February 23, 2011, meeting. One alternative would have clarified that water is not a flavoring, coloring, or blending material for purposes of BPC section 23007. The other alternative would have defined the term "wine base" and clarified that water is a blending material when added to a wine base. However, the Board did not agree with either alternative because there is still general disagreement in the wine industry as to whether water should be classified as a blending material and the Board has determined that it is not necessary to determine whether water is or is not a blending material in order to determine whether a wine-based alcoholic beverage is or is not a distilled spirit for tax purposes.

No Federal Mandate

The adoption of proposed Regulation 2558.1 was not mandated by federal statutes or regulations and there is no federal regulation that is identical to proposed Regulation 2558.1.